Final University of York response to the USS 2020 March 2020 Valuation Technical Provisions Consultation

1. Introduction and Context

The Urgent Decisions Group (UDG) (hereafter 'We') is a body of the University of York's Council, and has delegated authority on behalf of Council to consider and approve this consultation response. We have considered the document entitled "USS: A Consultation for the 2020 Valuation: A consultation with Universities UK on the proposed assumptions for the scheme's Technical Provisions (subsequently referred to here as the "Technical Provisions document") and welcomes the opportunity offered by the USS and Universities UK (UUK) to comment. We introduce our consultation response with a range of broader observations to recommend a full-scale review of the approach and the concerns this raises which, as a significant employer in the scheme, is important to identify at this critical stage in the consultation process for the benefit of the University as a whole, and that of its employee scheme members.

2. Reframing the approach

We are disappointed that the Trustee has chosen to set out this latest consultation in a narrowly framed way, using a similar approach to previous valuations and consultations.

We also consider there to be a number of serious issues to continuing with the current approach – an approach that has, in many respects resulted in an ongoing impasse with employers and disruption to both them and employees:

- The longstanding dispute with regard to the sustainability of the USS pension scheme has resulted in a profound lack of trust between the key stakeholders, and most importantly the nature and tone of iterative industrial strike actions has led to major, fundamental disruption for university staff and students and a polarisation of views and behaviours, that in turn has significantly damaged the relationship between UK HE and Government, policy-makers and more broadly the general public.
- We consider the lack of reference to the Joint Expert Panel (JEP) key recommendations regrettable, as these advised on framing future consultations around reshaping the governance of the scheme, re-establishing the running of the scheme in such a way that addresses intergenerational fairness, and the fact that current and future members are required to contribute towards deficits built up in respect of former members.

We strongly urge a reconsideration of this approach. The University of York has consistently supported the work of the JEP in trying to reflect the needs of all stakeholders, taking a long term and pragmatic approach to such matters, and we continue to hold this position. Given our comments above, we would advocate that the following measures are adopted:

- That a meeting is arranged between representatives of the employers, USS Trustee board members and executive and crucially, the Pension Regulator (tPR). A meeting that would take an explicit approach to engaging with all stakeholders in an open and transparent manner.
- That we should collectively and constructively reframe the unique context of the USS pension scheme that would seek to offer a longer term view of its sustainability in the following contexts:

  a. The UK HE sector is globally recognised for its contributions to societal and economic development - in the context of current and likely future Government strategy it is quite clear that the strongest parts of the UK HE sector (represented by USS pension scheme members) will be an integral part of a UK post-covid economic recovery plan. It is therefore not a credible position that the entire sector would fail, and fail simultaneously, given the reliance on education and research to support and drive national and global economic recovery;

b. The Covid-19 pandemic is the most serious economic crisis for more than 100 years but economic and societal recovery will happen - we need to therefore to view the viability of both the economy and the sustainability of the pension scheme over a much longer continuum than a 7 year debt recovery period as our response to the technical consultation questions makes clear;

c. In assessing the strength of the sector's covenant, for example, from a historical perspective the trend for higher education has expanded cyclically in order to respond to profound economic challenges and contractions~~,~~; i.e. the enormous growth in higher education to respond to the implications of the Industrial Revolution; the growth in higher education provision in response to the aftermath of the Second World War and to exploit the rise of technology in the 1960s; the shift and widening of access to higher education as a response to deep economic recession in the 1980s; and the insatiable demand for access to higher education from a rising middle class in key overseas markets (and the swiftness of the recovery in international recruitment post-SARS) all point to a sector that will continue to be attractive to students, and whose research will support long term economic recovery, and, pertinent to this situation, a need to take a longer term cyclical view of higher education and a longer-term analysis of the strength of its pension scheme relative to that long term strength of the sector.

More broadly there needs to be restoration of trust around how we develop truly collaborative and mutually beneficial negotiations to restore the psychological contract between employers, employee scheme member, the Trustee Board and tPR. We would recommend that a key objective of a new consultation period would be to align USS Trustee interests with the interests of those they represent - employers and their employees. The continuing 'arms-length' relationship between employers, employee scheme members and tPR will seed further distrust and anger among members which will further damage our collective reputation.

In an increasingly competitive and challenging environment, we need to ensure that the provision of USS (as the pension scheme for a great number of our valued staff) remains an attractive part of our overall benefit package. The benefits provided by USS must be worthwhile and valued by our employees.

Further the very high attrition rates (more than 20%) among young members leaving the scheme will do far more long term damage to the viability of the scheme. This needs to be addressed urgently with more creative solutions. It should be of significant concern to USS, as it is to our institution, that something as important as a pension benefit, is increasingly inaccessible to a growing number of potential members on affordability grounds, noting that this detrimental impact will have a disproportionate effect on lower paid staff, including part-time often female staff and other minority groups. Clearly any proposals that have the potential to affect any minority group should be subject to a comprehensive equality impact assessment, which should then inform transparent decision making, and we urge USS to pause, for this to be fully understood. We request that consideration is given to the introduction of an earnings related sliding member contribution rate scale, to make the Scheme more affordable for the lower paid.

3. General observations on the Technical Provisions document

In addition to the significant reservations we make in the introductory section above, taking into account the Technical Provisions document as whole, we offer the following specific comments on key areas of the consultation:

- The questions set out in the Technical Provisions document require a level of precision that is not facilitated by the wide range of data and information provided by USS itself within the consultation.
- In particular, the wide range of employer contribution outcomes cited within the Technical Provisions document is so broad, that it has not been easy to form a clear view on what they could mean for the University, both in terms of cash contributions and other matters such as benefit levels, security and exposure to investment risks. In order to do this we have considered the overall position and outcomes, rather than each of the eight detailed questions you posed.
- The absence of an up to date covenant assessment contributes to this, and it is not possible for us to comment meaningfully on the rates employers are being asked to pay and the employer covenant support requests until there is greater clarity around this point.
- Whilst we realise it is a matter for a later consultation, we believe it is appropriate to raise here that we believe the proposed debt monitoring provisions to be unduly onerous, and we would not be willing to agree to them in their current form. It is also not clear what the impact of providing contingent security would be on contribution rates and we believe that the proposed approach which leads to different outcomes for different employers is out of line with the principle of mutuality.
- We believe that a pre-retirement discount rate of Gilts + 3.5% should be adopted together with recovery period of 20 years. This is in line the JEP's proposals which we have already supported and for employers is a broadly similar risk position to the 31 March 2018 valuation
- The deficit recovery plan should also include an allowance for asset out-performance of 0.5% a year.
- Based on the numbers in the consultation documents and Aon's advice to UUK, we estimate that our proposal would result in total contributions of 31.4%, member contributions of 9.6% and employer contributions of 21.8% which would help to minimise any disruption which could be caused by this actuarial valuation at a challenging time for the participating employers in the USS. The Aon analysis also allows for a 2% deficit contribution. These contribution rates compare favourably with the current payments and are lower than those agreed from 1 October 2021.

4. Specific observations on Technical Provisions document

Deficit recovery period

- The actuarial valuation date of 31 March 2020 will present a challenge for all trustees undertaking an actuarial valuation at this date and their sponsoring employers. Given investment market uncertainty is likely to prevail under challenging global and domestic economic conditions, we need the USS to provide universities with the benefit of the doubt over the short term. The Pensions Regulator has generally been flexible and reasonable through the period since the pandemic started and this actuarial valuation requires the same attitude to make sure that outcomes do not do more damage than good.

- The USS considers that it has covenant visibility over 20 years or 30 years as it is prepared to assess affordable and acceptable contributions over these periods for the purpose of the risk metrics. Whilst we understand this is illustrative, we also believe this to have been discussed with tPR in principle. In our view, we therefore consider it appropriate for deficit contributions to be recovered over the same period. This is commensurate with the HE sector's status as a very long-term cash-generative collective employer group, and will result in a more affordable outcome for the University, and minimise the damage to our covenant over the short to medium term.

- We realise that the Pensions Regulator is generally and increasingly requiring strong employers to repay deficits sooner rather than later, but this is because there is general concern over covenant visibility. The principle is that a deficit recovery period should not be longer than the covenant visibility period. For strong employers we agree that covenant visibility and deficit recovery periods should be aligned and this should enable the USS to have a recovery period of at least 20 years.

- It is also appropriate, especially in the current environment, for any positive post-valuation experience to be taken account of when determining deficit contributions and we request that this is considered as part of the final results provided to JNC in due course and incorporated into final decisions on deficit recovery.

Discount rate derivation

- The JEP has proposed a pre-retirement discount rate assumption of Gilts+3.5%, and employers have confirmed support for this. It would therefore be reasonable for USS to agree to this, without having to agree to all of the employer support measures cited in the consultation.

- As advisor to Universities UK, Aon has set out its views on the Technical Provisions document. They have demonstrated that adoption of a Gilts + 3.5% pre-retirement discount rate results in an increase in prudence since the 2018 USS valuation. Indeed, if the confidence levels were aligned to 2018, then the pre-retirement discount could be higher.

- This position is further supported by considering appropriate adjustments in expected asset returns as at 31 March 2020 to take into account the very significantly depressed assets values and gilt yields at that date.

- Furthermore, the JEP suggested that the pre-retirement discount rate should be set with reference to CPI and since they issued their support there has been an increase in long-term CPI expectations versus gilt yields. We would support this in principle because it would provide greater funding stability between actuarial valuations. In particular though, the move in gilt yields and long-term CPI expectations have been such that JEP would likely be suggesting Gilts + 4% as at 31 March 2020 which reinforces the reasonableness of Gilts + 3.5% as a reasonable outcome.

- Therefore, we believe a pre-retirement discount rate of Gilts + 3.5% is appropriate and should not require additional employer support to sustain this.

- The single equivalent discount rate of CPI+0.5% that a pre-retirement discount rate assumption of Gilts +3.5% would translate to is significantly lower (and therefore more prudent) than the discount rate used by public service schemes (currently CPI + 2.4%, but may decrease to around CPI + 1.8%), including the Teachers' Pension Scheme.

Employer covenant support measures

- It is vital that the Autumn assessment of the covenant is carried out as soon as possible, and the outcome of that assessment confirmed to employers. This is required to provide employers with a condensed range of possible contribution outcomes.
- It is also not clear the impact that providing contingent security in the form that is currently being requested would have on contribution rates, and this needs to be made clear to employers.
- A reframing of the sector's covenant with those longer-term implications more fully assessed would lead to a recognition that wholescale sectoral failure is extremely unlikely
- Overall, the employer and covenant monitoring requests being proposed are too restrictive and provide USS with unacceptable amount of potential and possibly actual control over the University's operation and management.
  We therefore need to seek to redefine the Pension Regulator's classification system to reflect a continuum rather than a snapshot of the pension scheme as the current valuation methodology demands.
- If we would be willing to agree to some of the measures, these would need to contain less onerous thresholds and ratios. In the event that a University breaches the thresholds, then the resulting review of the course of action that follows would need to be determined with input from UUK, Vice Chancellors, Finance Directors, Registrars, UCU etc, and not exclusively left to the USS to determine.
- In agreeing to such measures, we would expect our covenant to be assessed as evidentially stronger as a consequence and for discount rates and the recovery periods to shift as set out above.

Future service employee benefits

- Whilst we recognise that the current consultation is in relation to the 2020 Valuation Technical Provisions, linked to this is the cost and risks of benefits continuing to be built up.
- The increase in costs that have been put forward in the consultation are unsustainable for both employers and employees and cannot be absorbed by either party. The level of employee costs is already such that nearly 20% of eligible members are choosing not to join the Scheme. This is unacceptable from our perspective and means that the Scheme is not meeting our objectives as an effective recruitment and retention tool.
- We ask that you consider the implications of being too prudent on the employers and the members and the potential knock-on consequences on the sector and therefore the covenant. In other words, there are significant risks in being too prudent, especially given the current market conditions and trading conditions for employers.
- There is a further concern that the Scheme will not provide adequate retirement benefits for all of our employees and is at risk of being non-inclusive in terms of the groups of eligible employees it serves, as well as the high level of opt-out rates referred to in paragraph 5 above.

5. <u>Conclusion</u>

We are very concerned about the impact of such uncertainty, for both the institution and our employees (for whom we recognise that pension benefits are a very significant element of the remuneration package) as well as the impact on our students. By their very nature, pension benefits need to be stable and attractive, and it is not in any party's interest (staff, students, the wider HE sector and therefore the USS) to have periods of significant disruption, as has been recently experienced. We wish to reiterate points we have made in the previous consultation about the JEP, namely that we want to see a serious ongoing commitment from all parties to engage in proposals to put the valuation methodology, and hence the overall scheme, onto a more sustainable basis for the future. Employers and the USS Trustee should work together to assist tPR to assess the scheme in a more comprehensive manner that takes account of its multi-employer membership scheme. The size and scale of the scheme provides reassurance that the scenario where all employers would fail at the same time - or at all is extremely unlikely. We need to work together to expand tPR's approach to overseeing this scheme because we believe that tPR's current regulatory framework needs to be adjusted to manage these distinctive characteristics of the USS Pension scheme**.** The Russell Group employers represent some of the strongest universities in the UK and more than 60% of the financial power of the scheme and therefore should have an over-riding influence on the approach and methodology adopted going forward.

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